

THE WORLD ECONOMY TODAY: WOULD LOUIS LANCASTER BE SURPRISED?

Benjamin J. Cohen
Louis G. Lancaster Professor of International Political Economy,
UCSB

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QUESTION

- If Louis Lancaster had fallen asleep in 1947 and woke up today, would he be surprised?

 - Answer: Yes and No...
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SOME SIMILARITIES....

- Federal deficit
 - Federal debt
 - Unemployment
 - Risk of renewed recession (or even depression)
 - Crisis in Europe
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BUT EVEN GREATER DIFFERENCES

- Increased number of sovereign states
 - Redistribution of economic power
 - Revival of Europe, Japan
 - Entrance of OPEC
 - End of the Soviet Union
 - Emergence of NICs, BRICs
 - Relative decline of the US
 - Most important: GLOBALIZATION
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GLOBALIZATION

- Essence: heightened openness and integration of national economies
 - Main advantage: promotes efficiency, growth, prosperity, reduction of poverty
 - Main disadvantage: intensifies sensitivities and vulnerabilities
 - To other governments
 - To market forces

 - Consequence for the US: no longer in sole control of our own destiny
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CONTRAST

□ 1947

- The US was the dominant “hegemon”
- Others were vulnerable to us
- Others looked to us for help (Marshall Plan, etc)

□ 2012

- US hegemony has declined
- We are now more vulnerable to others
- We now often look to others for help

□ Louis Lancaster would indeed be surprised...

WHAT LOUIS LANCASTER WOULD SEE IN 2012: US PROSPECTS

- Some reasons for optimism
 - Job creation
 - Rising industrial production
 - Improving economic sentiment
 - More reasons for pessimism
 - Mild winter (exaggerated job growth)
 - Housing market (still weak, with inventory overhang)
 - Consumption (still weak, as households deleverage)
 - Business investment (still weak; most of recent spurt of growth was due to inventory restocking, which couldn't last)
 - Net exports (hurt by rising oil prices)
 - Government sector (austerity prevails)
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MOST IMPORTANT: RISKS FROM ABROAD (VULNERABILITIES)

- Dollar crisis?
 - Europe?
 - Oil?
 - China?
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DOLLAR CRISIS?

- The main threat: US fiscal policy
 - Presently, low borrowing costs owing to the international role of the dollar
 - But political dysfunction in Washington could trigger flight to other currencies, driving up interest rates
 - Potential consequences
 - Higher government borrowing costs
 - Lower business and household spending
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EUROPE?

- Recent causes for optimism
 - ECB Long-Term Refinancing Operation
 - Greece rescue
 - Enlarged “firewall”
 - More likely: mere calm before another storm
 - Greece is still in trouble
 - Spain, other PIIGS are also still at risk
 - Firewall is less than meets the eye
 - Euro zone is sinking into recession
 - Governance remains a problem
 - US is vulnerable through two channels
 - Finance (US banks and money market funds)
 - Trade (1/4 of US exports go to Europe)
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OIL?

- Positives
 - Declining foreign dependence
 - Greater fuel efficiency
 - Shale oil, natural gas boom
 - But still vulnerable to an oil shock
 - Little excess capacity
 - Limited strategic reserves
 - Iran?
 - Potential consequences
 - Inflation
 - Renewed recession
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CHINA?

- Signs of increasing fragility
 - Unbalanced growth
 - Rising labor costs
 - Real estate bubble
 - Vulnerable banking system
 - Possible consequences of an abrupt slowdown
 - Direct impact on US commodity exports
 - Indirect impact through US trading partners
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CONCLUSION

- The world really has changed in 65 years: risks are now considerable, both at home and abroad

 - Questions to ponder:
 - Should globalization be reversed?
 - Can globalization be reversed?
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